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SPECIAL USE VALUATION UNDER THE INTERNAL REVENUE CODE: DOES IT MATTER NOW AND WILL IT MATTER IN THE FUTURE?

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I. INTRODUCTION

Congress recognized in the Tax Reform Act of 1976 that the federal estate tax might have a much higher burden on farmers and small business owners because of a lack of liquidity.[1] Congress passed 26 U.S.C. § 2032A to allow succeeding generations of farmers to use special use valuation by valuing real property based on its value as agricultural land rather than on its highest and best use.[2] Today, a very strong argument can be made as to the waning importance of the primary purpose of the statute (i.e. to decrease the amount of the taxable estate) because of factors such as the increasing Unified Credit;[3] however, an important benefit has yet to be realized.

Since the passage of § 2032A over thirty years ago, it has been challenged and amended numerous times.[4] The legislative, administrative, and judicial history of this statute, discussed throughout this article, shows how it has adapted over time to encompass the citizens whom Congress intended to benefit. This rich legal history has fashioned a law that can be used as a future guide for both Congress and administrative agencies to craft laws aimed towards more narrowly tailored groups involved in agriculture. While § 2032A remains largely relegated to only the federal estate tax system, there is one active bill, the Family Farm Preservation and Conservation Estate Tax Act, which would incorporate large sections of § 2032A into its framework.[5]

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[1] H.R. REP. NO. 94-1380, at 3 (1976).

[2] *See* 26 U.S.C.A. § 2032A (West 2012); H.R. REP. NO. 94-1380, pt. C, at 21-22.

[3] 26 U.S.C.A. § 2010 (West 2010). The Unified Credit as it currently exists was created in 1976 and works with both the federal gift tax and the estate tax. It is a credit that can be used by an individual during life or at death and the amount of the credit has been adjusted upwards ever since its inception.

[4] *See, e.g.*, Teubert v. United States, No. 3-82-43, 1983 WL 1615 (D. Minn. 1983) (interpreting 26 U.S.C. § 2032A(d)); Whalen v. United States, 826 F.2d 668, 669-70 (7th Cir. 1987) (discussing the qualified heir requirement when 26 U.S.C. § 2032A was enacted in 1976 and after being amended in 1978); Minter v. United States, 19 F.3d 426, 429 (8th Cir. 1994) (discussing whether a family farming corporation qualifies for special use valuation).

[5] *See* H.R. 390, 112th Cong. (2011).

Presently, § 2032A is of little value to the vast majority of estate planners because of the high Unified Credit amount; however, § 2032A may become important in the future because use of this provision closely resembles the cyclic nature of agriculture. As farm sizes continue to increase to accommodate commercial farming, future land prices will most likely increase due to demand. This means that while the primary purpose of the statute is not as useful today as it has been in the past, history indicates that it may very well cycle around again in the future as a result of the high cost of land. When coupled with the extensive legislative, administrative, and judicial history of the statute, there is a clear possibility for the statute to extend beyond the federal estate tax and into other agricultural programs in the future.

This Article provides an introduction into special use valuation for estate planning for family farms and businesses. More specifically, Section II presents an overview of the federal estate tax regarding special use valuation. Section III details Congress's intent and the purposes behind enacting 26 U.S.C § 2032A, and Section IV discusses the specific requirements of § 2032A in more detail. Finally, Section V reviews current legislation that could amend § 2032A and increase its usefulness.

II. THE FEDERAL ESTATE TAX

The federal gift and estate taxes have changed drastically over time, which has forced estate planners and tax specialists to be flexible in their approach of assisting clients in passing on their assets to the next generation with the lowest taxes possible. Often, in the case of family farms and businesses, there is the added goal of passing on not just the assets of the previous generation, but also the operation itself. Minimizing estate and gift taxes for a client can be relatively simple when compared to the amount of work that is involved with succession planning since the family farm or business as a whole, or in part, is transferred to the next generation either over a period of time or immediately after the death of the decedent. Since the assets of a family farm or business are needed for its continued operation, the executor of the decedent's estate, who is often one of the heirs that will continue the family farm or business, will generally try to avoid the disposition of such assets to keep the operation economically viable. This puts estate planners in a difficult position because they want to minimize the tax burden on the estate while allowing the operation to successfully continue forward with the next generation. On its face, this may appear to be a grave problem, but there are very few citizens who must pay estate taxes currently because of various provisions in the tax code.

The federal estate tax affects farmers and small business owners differently each year because of changes in variables that determine the

ultimate impact, such as the strength of the economy, inflation, land values, and the Unified Credit. The estate tax may have a dramatic effect on any business or farming operation depending upon the size of the operation and the professional planning the decedent obtained prior to his or her death. Contrary to popular belief, the estate tax only applies to roughly two percent of all the estates created in a given year; however, small businesses and farms are twice as likely to face estate taxes at the death of the decedent.[6] Congress has created numerous exemptions and exceptions over the years in an effort to prevent the estate tax from adversely impacting family-owned businesses and farms, even though there is a relatively small percentage of the population affected by estate tax. Examples of these exemptions include the Unified Credit, the Family Owned Business Deduction (FOBD),[7] the allowance for estate taxes due on small businesses (including farms) to be paid in installments at a low interest rate,[8] valuation discounts for interests in property that are less than complete ownership,[9] and finally the special use valuation provision found in § 2032A.

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[6] *See* JANE G. GRAVELLE & STEVEN MAGUIRE, CONG. RESEARCH SERV., RL33070, ESTATE TAXES AND FAMILY BUSINESSES: ECONOMIC ISSUES (2007) ("Evidence suggest, however, that only a small fraction of estates with small or family business interests have paid the estate tax (about 3.5% for businesses in general, and 5% for farmers, compared to 2% for all estates).").

[7] *See*, H.R. 4042, 110th Cong. (2007) (proposed legislation that could bring § 2057 back into the estate planning picture since the new legislation would bring the FOBD back in at $8 million).

Due to this fact, the provision may become important to estate planners in the future who are dealing with the estate of a small family business or farm. This statute essentially allows the estate planner, in the case of a qualifying estate, to deduct from the gross estate the lesser of the "adjusted value of the qualified family-owned business interests of the decedent" includible in the gross estate or $675,000, however this amount decreases as the Unified Credit increases making it less effective each year. Because this code section functions similarly to § 2032A it is difficult to use correctly and the benefit behind it are low (currently it cannot even be used). *See* DONALD H. KELLEY, DAVID A. LUDTKE, & BURNELL E. STEINMEYER, JR., ESTATE PLANNING FOR FARMERS AND RANCHERS § 17:1 (3d ed. 2002 & Supp. 2011).

[8] 26 U.S.C.A. § 6166 (West 2001); *see also* JOHN R. PRICE & SAMUEL A. DONALDSON, PRICE ON CONTEMPORARY ESTATE PLANNING §§ 11.23-11.25, (Wolters Kluwer 2007) (stating that this provision to defer the payment of estate taxes may be used with closely-held business interests if the business qualifies. To qualify for this deferral the closely-held business interest must exceed thirty-five percent of the decedent's adjusted gross estate (the surviving spouse's joint tenancy or tenancy in common interest is included in the thirty-five percent), the election must be made when the estate tax return is filed, the election must contain the required information, the business must be an active business and not merely a way to manage investments or assets, and only "active" assets that are used in the closely-held business are counted in reaching the thirty-five percent (which means that the farmhouse and other similar assets may not be included in reaching the thirty-five percent)).

[9] *See* PRICE, *supra* note 8, at § 11.29 (stating that when there is only a minority interest in property there may be a lack of marketability causing the property to be discounted in value).

III. THE INTENT OF SPECIAL USE VALUATION

In 1976, Congress passed what is recognized today as § 2032A.[10] At that time all property included in the gross estate of the decedent was valued at fair market value, which is essentially valuation at the property's highest and best use.[11] In the statute's legislative history, the House of Representatives stated it is "inappropriate to value the land on the basis of its potential 'highest and best use' especially since it is desirable to encourage the continued use of property for farming and other small business purposes."[12] The statute is intended to preserve family farms and closely-held businesses.[13] Congress addressed two issues with the enactment of § 2032A, which may have historically assisted in the decline of the number of farms and family businesses.[14] First, Congress lowered the estate tax burden by allowing real property to be valued not at fair market value, but rather at the value of its current use, which may be significantly lower depending upon development opportunities in the surrounding area.[15] The second problem that Congress addressed was the lack of liquidity of farms and small businesses; since most assets are invested in the operations, liquidation of these assets would normally make it impossible for businesses to continue to operate.[16] Congress hoped that lowering estate taxes faced by farmers and small business owners would enable the next generation of heirs to continue the family business.[17]

Congress did not intend to merely create a windfall, which heirs of small farms and businesses could reap immediately by selling off the assets of the estate.[18] The majority of the text found in § 2032A consists of limitations and exceptions to the application of special use valuation. These include what can be valued, how long the real property must be owned,

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[10] 26 U.S.C.A. § 2032A (West 2012).

[11] H.R. REP. NO. 94-1380, pt. C, at 18 (1976).

[12] *Id.* at 22.

[13] *See* I.R.S. Tech. Adv. Mem. 80-41-016 (June 30, 1980) ("Beneficial use of section 2032A is premised on an avoidance of liquidating the family farming operation where possible.").

[14] *See id.* ("There were two primary purposes for the enactment of section 2032A for farms. First, the lower valuation encourages the continuation of the family farming operation by basing the included value at its use value rather than the fair market value. Second, the statute provides a relief measure so that an estate does not have to dispose of the farm because of liquidity problems.").

[15] *Id.; see also* H.R. REP. NO. 94-1380, pt. C, at 22 (stating that valuation on the basis of the highest and best use, rather than actual use, may result in the imposition of substantially higher estate taxes. In some cases, "the greater estate tax burden makes continuation of farming, or the closely held business activities, not feasible because the income potential from these activities is insufficient to service extended tax payments or loans obtained to pay the tax. Thus, the heirs may be forced to sell the land for development purposes. Also, where the valuation of land reflects speculation to such a degree that the price of the land does not bear a reasonable relationship to its earning capacity, your committee believes it unreasonable to require that this 'speculative value' be included in an estate with respect to land devoted to farming or closely held businesses.").

[16] I.R.S. Tech. Adv. Mem., *supra* note 13; H.R. REP. NO. 94-1380, pt. C, at 22.

[17] H.R. REP. NO. 94-1380, pt. C, at 22.

[18] *See id.* at 22.

who may be a qualified heir, how long must the farm or business remain operating to avoid recapture, and what activities must the decedent and the heirs do to maintain eligibility.[19] Congress used these limitations and exceptions in the statute as an effort to tailor it specifically to those whom Congress intended it to benefit.

IV. USING SPECIAL USE VALUATION UNDER § 2032A

Special use valuation under the Internal Revenue Code (Code) is one of the more complex provisions found within the Code; therefore, special care must be exercised in order to fully comply with this specific provision. There are numerous steps that must be followed in order to qualify the estate[20] to receive the special use valuation, and each of these steps must be carefully observed in order to satisfy the IRS. Otherwise, the election will fail. The general requirements are that: 1) the decedent, at the time of his or her death, was a citizen or resident of the United States;[21] 2) the executor must timely elect to use this provision on the federal estate tax return,[22] commonly called form 706; and 3) the executor must file an agreement signed by each person currently living who has an interest in the real property, whether possessory or not, stating they assent to the burdens placed upon the property.[23]

Only real property may be valued under this provision and this property must reside in the United States.[24] Further, for the property to use special use valuation it must meet the criteria for "qualified real property" found in § 2032A(b).[25] To be a qualified real property: 1) the decedent, or a member of the decedent's family, must have used the real property for farming purposes or in a trade or business other than farming;[26] 2) fifty percent or more of the adjusted value of the gross estate consists of the adjusted value of real or personal property that was being used for a qualified use by the decedent and was acquired from or passed on by the decedent to a qualified heir of the decedent;[27] 3) at least twenty-five percent of the adjusted value of the gross estate consists of the adjusted value of

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[19] *Id.* at 22-23.

[20] Special use valuation may only be used with estate taxes. Despite the close relation between gift taxes and estate taxes, the language of § 2032A(a) does not allow for this valuation provision to be used on any real property unless it is passed on by a qualified decedent. NEIL E. HARL, AGRICULTURAL LAW MANUAL § 5.03(2) (Release no. 52, 2008).

[21] 26 U.S.C.A. § 2032A(a)(1)(A) (West 2012).

[22] 26 U.S.C.A. § 2032A(a)(1)(B).

[23] 26 U.S.C.A. § 2032A(a)(1)(B), (d)(2).

[24] 26 U.S.C.A. § 2032A(b)(1).

[25] 26 U.S.C.A. § 2032A(a)(1), (b).

[26] 26 U.S.C.A. § 2032A(b)(1)(C), (b)(2).

[27] 26 U.S.C.A. § 2032A(b)(1)(A).

real property;[28] 4) during the eight years before the decedent's death, the decedent or a member of his or her family must have owned and used the real property in its qualified use for an aggregate of five years or more;[29] and 5) the real property must have been owned by the decedent or a family member while being put to a qualified use and there must have been material participation on the part of the decedent before the transfer of the property.[30]

Once the requirements of § 2032A are met, the executor must determine which valuation method to employ to minimize the value of the qualified real property in the estate.[31] The first method, § 2032A(e)(7), provides for the valuation of farmland. It is the most commonly used of the two provisions and theoretically provides the greatest savings if the estate can qualify as farmland.[32] The second method, § 2032A(e)(8) can be used for either farm valuation purposes or for closely-held business interests where § 2032A(e)(7) does not apply; however, the allowable means for valuation are not as generous as those found in § 2032A(e)(7) meaning the benefit provided by this provision is substantially less.[33]

In order to make a special use valuation election under § 2032A, the family members of the decedent must agree to carry on the farm or business.[34] This ongoing obligation makes § 2032A different than other Code provisions and essentially creates a binding contract between the IRS and the qualified heirs to keep the farming operation in existence.

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[28] 26 U.S.C.A. § 2032A(b)(1)(B).

[29] 26 U.S.C.A. § 2032A(b)(1)(C).

[30] 26 U.S.C.A. § 2032A(b)(1)(C)(ii).

[31] *See* 26 U.S.C.A. § 2032A(e)(7), (e)(8).

[32] *See* 26 U.S.C.A. § 2032A(e)(7) (establishing that the value of a farm is determined by dividing "the excess of the average annual gross cash rental for comparable land used for farming purposes and located in the locality of such farm over the average annual State and local real estate taxes for such comparable land, by the average annual effective interest rate for all new Federal Land Bank loans.").

[33] *See* 26 U.S.C.A. § 2032A(e)(8). (allowing valuation by considering several factors, including the capitalizing income which the property can expect to generate "over a reasonable period of time under prudent management," "capitalization of the fair rental value of the land for farmland or closely-held business purposes," assessed land values in a state which allows for or provides a different means of valuation, "comparable sales of other farm or closely held business land in the same geographical area far enough removed from a metropolitan or resort area so that nonagricultural use is not a significant factor in the sales price," or "[a]ny other factor which fairly values the farm or closely held business value of the property.").

[34] *See* 26 U.S.C.A. § 2032A(c).

A. Initial Qualifications and Limitations

1. Election of Special Use Valuation

Election of special use valuation has several requirements. First, the executor must timely elect to use this provision on the federal estate tax return, Form 706.[35] Once the executor has affirmatively made the election, it is irrevocable.[36] The estate may not elect to use special use valuation to reduce the value of the decedent's estate by more than $1,040,000, as of 2012 when adjusted for inflation.[37] For the election on Form 706 to be valid, the executor must include specific information contained in a "notice of election," as well as, a written agreement regarding the special valuation made by the qualified heirs.[38] The election to use special use valuation must be included with the timely filed estate tax return and will not be accepted in an amended return filed at a later date.[39]

Information that must be provided in the "notice of election" includes: 1) the decedent's name and taxpayer identification number; 2) the relevant qualified use, either as a farm or a closely-held business; 3) "[t]he items or real property shown on the estate tax return to be specially valued pursuant to the election;" 4) "the fair market value of the real property to be specially valued under section 2032A and its value based on its qualified use;" 5) the adjusted value of all real property that is used for a qualified use and that passes from the decedent to a qualified heir, and the adjusted value of all real property to be specially valued; 6) the items of personal property shown on the estate tax return that pass from the decedent to a qualified heir and have a qualified use under § 2032A and the total value of such personal property; 7) the adjusted value of the gross estate; 8) "[t]he method used in determining the special value based on use;" 9) "[c]opies of written appraisals of the fair market value of the real property;" 10) a statement that the decedent and/or a member of his family has owned all specially valued real property for at least five years of the eight years immediately preceding the date of the decedent's death; 11) "[a]ny period during the [eight] year period preceding the date of the decedent's death during which the decedent or a member of his or her family did not own the property, use it in a qualified use, or materially participate in the operation

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[35] 26 U.S.C.A. § 2032A(a)(1)(B); Treas. Reg. § 20.2032A-8(a)(1), (a)(3) (as amended in 1981).

[36] Treas. Reg. § 20.2032A-8(a)(1).

[37] 26 U.S.C.A. § 2032A(a)(2), (a)(3).

[38] Treas. Reg. § 20.2032A-8(a)(3), (c)(1).

[39] *See* Teubert v. United States, No. 3-82-43,1983 WL 1615,at *1 (D. Minn. 1983) (holding that plaintiff's failure to make a timely special use valuation election expressly waived such election); *see also* Estate of Boyd v. Comm'r, 46 T.C.M. (CCH) 328 (1983) (stating that even if there is reasonable cause for the failure to make a timely election, the election will still be denied for failure to comply with statutory requirements).

of the farm or other business;" 12) "[t]he name, address, taxpayer identification number, and relationship to the decedent of each person taking an interest in each item of specially valued property, and the value of the property interests passing to each such person based on both fair market value and qualified use;"13) "[a]ffadavits describing the activities constituting material participation and the identity of the material participant or participants;" and 14) "[a] legal description of the specially valued property."[40]

Additionally, the estate must include an agreement signed by all parties, in being, that have an interest in the specially valued property.[41] All parties who have any interest in the property,[42] whether that interest is possessory or not, must sign and assent to being held personally liable under § 2032A(c) "in the event of certain early dispositions of the property or early cessation of the qualified use."[43] This agreement "must express consent to collection of any additional estate taxes imposed under section 2032A(c) from the qualified property" and must be binding on all parties having an interest in the property.[44] The written agreement shall designate an agent with authority to act for all of the signing parties in any future dealings with the IRS.[45]

As evidenced from the list of requirements that the executor of the estate must fulfill in order to elect special use valuation, the process is long, complex, and susceptible to mistakes. Due to the requirements technical nature, Congress has built into the statute means by which the executor can make corrections and amendments to the filing to maintain the right to use special use valuation.[46] Prior to this revision, elections were disallowed because of late and incomplete filings.[47] Originally, Congress amended §

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[40] Treas. Reg. § 20.2032A-8(a)(3).

[41] 26 U.S.C.A. § 2032A(d)(2).

[42] Treas. Reg. § 20.2032A-8(c)(2) ("An interest in property is an interest which, as of the date of the decedent's death, can be asserted under applicable local law so as to affect the disposition of the specially valued property by the estate. Any person in being at the death of the decedent who has any such interest in the property, whether present or future, or vested or contingent, must enter into the agreement. Included among such persons are owners of remainder and executory interests, the holders of general or special powers of appointment, beneficiaries of a gift over in default of [sic] exercise of any such power, co-tenants, joint tenants and holders of other undivided interests when the decedent held only a joint or undivided interest in the property or when only an undivided interest is specially valued, and trustees of trusts holding any interest in the property.").

[43] Treas. Reg. § 20.2032A-8(c); 26 U.S.C.A. § 2032A(a)(1)(B), (d)(2).

[44] Treas. Reg. § 20.2032A-8(c)(1).

[45] *Id.*

[46] 26 U.S.C.A. § 2032A(d)(3).

[47] *See* Teubert v. United States, No. 3-82-43,1983 WL 1615,at *1 (D. Minn. 1983) (disallowing an amended return with the election to use special use valuation); Estate of Boyd v. Comm'r, 46 T.C.M. (CCH) 328 (1983) (disallowing an election even though the reason for filing late was because of a will contest in state court); Estate of Di Fiore v. Comm'r, 54 T.C.M. (CCH) 1168 (1987) (denying an election because the executor could not rely on a delegation of responsibility for preparing the return to executer's agents).

2032A in the Tax Reform Act of 1984 to allow for small mistakes.[48] The language of the 1984 amendment allowed for the correction of procedural defects in elections already filed so long as they "substantially comply" with the requirements set forth by the statute and the regulations.[49] What exactly "substantially comply with" meant was open to interpretation and caused many inconsistencies in the application of this statute.[50] Two years later, in 1986, Congress once again amended § 2032A and stated that so long as the return provided "substantially all the information" required, the election would be treated as valid as long as the executor submitted all of the missing information requested by the Department of Treasury within ninety days.[51] Finally, in 1997, Congress amended §2032A once more by removing all language concerning "substantial compliance" and put forth the current test.[52] Presently, the executor has the opportunity to correct almost any omission that the IRS finds and/or provide any information that the IRS requests, with the exception of certain mistakes.[53] Congress's attempts to provide a more flexible application of special use valuation verifies Congress's intent to provide relief from estate taxes for certain qualified farmers and small business owners so that their operations may be transferred to the next generation and not just their assets.[54]

2. *Technical Requirements of the Election*

Congress has tailored § 2032A to only benefit a unique class of people, essentially, active farmers and business owners that are passing their operations down to family members at their death.[55] In order to narrowly tailor the statute to such a specific group of people, Congress has included many requirements within the special use valuation statute. These

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[48] James C. Exnicios, *Federal Taxation*, 40 LOY. L. REV. 1, 16 (1994).

[49] *Id.* at 16-17.

[50] *Compare* Prussner v. United States, No. 85-2442, 1987 WL 47915, at *3 (C.D. Ill. 1987) (allowing corrections where the recapture agreement was missing information and two of the beneficiaries's signatures were absent), *with* McDonald v. Comm'r, 853 F.2d 1494, 1501 (8th Cir. 1988) (disallowing the correction of the filing of an amended return after the due date when the original return did not have the signatures of the decedent's children who were beneficiaries of the estate).

[51] BORIS I. BITTKER & LAWRENCE LOKKEN, FEDERAL TAXATION OF INCOME, ESTATES AND GIFTS ¶ 135.6.6, at 11 n.84 (Thompson/RIA 2011).

[52] 26 U.S.C.A § 2032A(d)(3) (West 2012) ("Modification of election and agreement to be permitted.--The Secretary shall prescribe procedures which provide that in any case in which the executor makes an election under paragraph (1) (and submits the agreement referred to in paragraph (2)) within the time prescribed therefore, but--(A) the notice of election, as filed, does not contain all required information, or (B) signatures of 1 or more persons required to enter into the agreement described in paragraph (2) are not included on the agreement as filed, or the agreement does not contain all required information, the executor will have a reasonable period of time (not exceeding 90 days) after notification of such failures to provide such information or signatures.").

[53] *Id.*

[54] *See* H.R. REP. NO. 94-1380, pt. C, at 21-22 (1976).

[55] *Id.*

requirements have been revised several times over the life of the statute in a further effort to target the statute at those who are intended to reap the benefit. The application for special use valuation is complex, but necessary to determine whether the estate is eligible for the election.

Only real property qualifies to be specially valued; however, an estate does not have to elect that all real property, or even all the real property that is qualified, be specially valued.[56] While the estate does not have to elect to use special use valuation on all qualified real property found in the estate, it must meet the minimum threshold requirements found in §2032A(b)(1)(B).[57] This minimum threshold requires that the estate have 1) twenty-five percent or more of the adjusted value of the gross estate that was acquired from or passed from the decedent to a qualified heir of the decedent; 2) during five of the eight years preceding the decedent's death the property was owned by the decedent or a member of the decedent's family; 3) there was material participation by the decedent or a member of the decedent's family; and 4) such real property is designated in the written agreement signed by the heirs acquiescing to the special use valuation and agreeing to maintain the operation for ten years.[58]

3. Citizenship, Property, and Property Location

To tailor the statute for its intended purpose, Congress placed several broad, overarching restrictions on the use of the statute that are highly mechanical; however, they must be met before any further consideration of the statute is given.[59] First, the decedent, at the time of his or her death, must be a citizen or resident of the United States.[60] Property owned by a foreign citizen or business organization that is not considered a resident of the United States cannot receive special use valuation.[61] Second, only real property may be specially valued under this provision and this property must reside in the United States to qualify for special use valuation.[62] This is a major difference from the Family-Owned Business Deduction (FOBD) found in § 2057 since none of the farm or business equipment can be valued at a special use valuation under that statute.[63] Such prohibition can dramatically limit the use of § 2032A in operations that intensively farm small acreages.

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[56] Treas. Reg. § 20.2032A-8(a)(2)(a) (as amended in 1981).

[57] *Id.*

[58] 26 U.S.C.A. § 2032A(b)(1)(B), (b)(1)(D).

[59] *See* 26 U.S.C.A. § 2032A.

[60] 26 U.S.C.A. § 2032A(a)(1)(A).

[61] *See generally* 26 U.S.C.A. § 2032A(a)(1)(A) (stating that for special use valuation "the decedent was (at the time of his death) a citizen or resident of the United States.").

[62] 26 U.S.C.A. § 2032A(b)(1).

[63] *See generally* 26 U.S.C.A. § 2032A.

However, throughout § 2032A there are references to personal property that passes to qualified heirs, as well as a requirement that such property be valued and this value be included in the notice of election that is filed with the estate tax return.[64] Personal property is important in meeting the requirements to use special use valuation,[65] however the personal property can only be valued at market price since § 2032A only permits special use valuation on real property.[66] In *Estate of Geiger v. Comm'r.*, the court held that personal property from a hardware business could not be included as qualified personal property as it was unrelated to the farming operation of the decedent.[67] Personal property that is intrinsically tied to the business or farming operation, which the executor is otherwise entitled to use special use valuation, may be included in the valuation process under this statute in order to meet the fifty percent of the adjusted gross value of the estate requirement.[68] However, the personal property itself is not subject to special use valuation.[69] The IRS tempered this result, by allowing the aggregation of two or more separate farming operations or closely-held businesses, so long as they would qualify otherwise.[70] Unrelated personal property is still not allowed in determining whether an estate meets the fifty percent requirement.[71]

Special use valuation may be used to value either closely-held businesses or farming operations that were owned and operated by the decedent subject to many rules.[72] One subject that is important to consider before electing to use § 2032A is how the business or farm is owned. Depending on the structure of the business or farm, the use of § 2032A may be restricted.[73] Section 2032A incorporates the definition of a qualifying interest in a closely-held business found in 26 U.S.C. § 6166(b)(1).[74] Sole proprietorships qualify by definition since the owner has sole ownership over the business.[75] Partnership and corporate stock ownership of a farm or closely-held business might suffice if it meets the statutory requirements.[76] An owner of the partnership or corporation must own twenty percent or more of the total capital interest in the partnership or twenty percent or

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[64] 26 U.S.C.A. § 2032A(b)(1).
[65] H.R. 4042, 110th Cong. (2007).
[66] 26 U.S.C.A. § 2032A(a)(1)(B).
[67] Estate of Geiger v. Comm'r, 80 T.C. 484, 487, 490-91 (1983).
[68] *Id.*
[69] 26 U.S.C.A. § 2032A(a)(1)(B).
[70] 26 U.S.C.A. § 6166(c) (West 2001).
[71] *See* 26 U.S.C.A. § 2032A(b)(1)(A), (a)(1)(B)
[72] *See generally* 26 U.S.C.A. § 2032A.
[73] 26 U.S.C.A. § 2032A(g).
[74] *Id.*
[75] 26 U.S.C.A. § 6166(b)(1)(A).
[76] 26 U.S.C.A. § 6166(b)(1).

more of the voting stock of a corporation.[77] These ownership interests must be a part of the decedent's gross estate in order to qualify.[78] Finally, the number of partners or stockholders may not exceed forty-five.[79]

If the decedent's qualifying property is owned through a business entity, such as a partnership or corporation and it meets the ownership requirements found in § 6166, a related difficulty may arise. A fractional ownership in a business or piece of property is worth significantly less than the actual fair market value of the interest.[80] It is a common strategy among estate planners to fractionalize control and ownership of property and businesses in order to create a fractional discount.[81] For example, suppose a decedent owned a farming operation worth $10,000,000 and completely unrelated investments that are also worth $10,000,000. An estate planner recommends that the client create a business entity to own the farm and that shares of this business be distributed to the qualified heirs at the client's death so that the estate can use special use valuation. By dividing the farming operation up among the decedent's heirs, the estate planner has created a fractional discount of up to forty percent, which would reduce the value of the farming operation to $6,000,000. The estate planner has saved the estate a significant sum of money, close to $2,000,000 in taxes, but because the value of the farming business is below fifty percent of the decedent's gross estate they may no longer use special use valuation.[82] An estate planner must therefore be aware of the many nuances surrounding special use valuation to determine both whether it should be used and if the option is available to the decedent after other strategies have been implemented.

4. Qualified Heirs

For the purpose of special use valuation the term "qualified heirs" is of particular importance and a mistake by an estate planner in identifying qualified heirs can cause a fatal flaw in the election. "The term 'qualified heir' means, with respect to any property, a member of the decedent's family who acquired such property (or to whom such property passed) from the decedent."[83] Decedent's "member of family" is likewise defined in the text of the statute and includes an ancestor of the decedent, the spouse of

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[77] *Id.*
[78] *Id.*
[79] *Id.*
[80] *See* Shepherd v. Comm'r, 115 T.C. 376 (2000), *aff'd* 283 F.3d 1258 (11th Cir. 2002).
[81] JOHN A. BOGDANSKI, FEDERAL TAX VALUATION ¶ 4.03, at 1 (2011).
[82] *See* 26 U.S.C.A. § 2032A(b)(1)(A) (West 2012).
[83] 26 U.S.C.A. § 2032A(e)(1).

the decedent, a lineal descendant of the decedent, descendant's spouse, or parent, or finally, the spouse of any such lineal descendant.[84]

The IRS has been particularly strict in interpreting qualified heirs in the past as seen in *Whalen v. United States,* where the IRS challenged whether a stepdaughter of the decedent (who was never officially adopted) could be considered a qualified heir under § 2032A.[85] While stepchildren are currently included as a qualified heir, at the time of this lawsuit lineal descendants of the spouse were not included in the definition of "member of family" and the IRS challenged the special use valuation only as to the stepdaughter.[86] The IRS was successful in their challenge in *Whalen* and has also been successful in other cases challenging special use valuation because of the selection of an improper heir.[87] The selection of qualified heirs for the purpose of special use valuation is critical to making a successful election because of the mechanical nature of this section. Only those that are specifically mentioned in the statute will be eligible as a qualified heir,[88] but there is at least one way that a potential heir can technically qualify under the language of the statute, but still fail to be considered as a qualified heir. Spouses of lineal descendants will remain as qualified heirs even after the death of the spouse, who was a lineal descendant of the decedent, unless that spouse remarries to a non-qualified person before the death of the decedent.[89]

It is critical for the estate planner, decedent, and the executor to determine early in the process whether intended beneficiaries are qualified heirs. Real and personal property used in the closely-held business or farming operation should be passed to the qualified heirs in order to meet the requirement that at least fifty percent of the adjusted gross value of the gross estate was acquired from or passed on by the decedent to a qualified heir of the decedent.[90] If the beneficiaries of the decedent are not carefully evaluated before the property is allotted to each heir, the election will be found to be invalid even if the rest of the requirements are met.[91]

5. Qualified Use

In an effort to target the special use valuation provision to farmers and small business owners, Congress required that any property to be

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[84] 26 U.S.C.A. § 2032A(e)(2).
[85] Whalen v. United States, 826 F.2d 668, 668-69 (7th Cir. 1987).
[86] *Id.*
[87] *Id.* at 670-71.
[88] 26 U.S.C.A. § 2032A(e)(1)-(2).
[89] I.R.S. Priv. Ltr. Rul. 84-12-014 (Dec. 2, 1983); Rev. Rul. 81-236, 1981-2 C.B. 172.
[90] 26 U.S.C.A. § 2032A(b)(1).
[91] 26 U.S.C.A. § 2032A(a)(1), (b)(1).

valued under § 2032A must meet the qualified use test.[92] The qualified use provision defines how the property must be used and the material participation in the farming or business enterprise requirement, which determines what activities of the decedent and/or the decedent's heirs will satisfy the requirements of the statute.[93] These are the two principal means by which Congress severely restricts the application § 2032A and narrowly tailors it for its specific purpose. The two provisions are separate requirements, however, they work together to ensure that only active, participating farmers and business owners may use special use valuation when calculating estate taxes.

The qualified use requirement is one of the first gatekeepers in § 2032A. "For purposes of [§ 2032A], the term 'qualified use' means the devotion of the property to any...use as a farm for farming purposes, or use in a trade or business other than the trade or business of farming."[94] Determining whether or not an estate meets the qualified use requirement is simple; however, determining whether there has been a cessation of the qualified use either by the decedent for more than three years within the eight years proceeding death, disability, or retirement or by the qualified heirs during the term of the statute is much more difficult.[95]

For the decedent to pass the qualified use test they must also inevitably fulfill the material participation requirement discussed below. If they fail to meet the material participation requirement, or if they do not maintain the qualified use for the required amount of time, then this cessation of the qualified use will trigger the recapture provision.[96]

Farms and businesses that are owned through business entities may qualify under the qualified use provision.[97] In *Minter v. United States*, a family farming operation was incorporated and the decedent's wife cash rented her share of the farmland to the family corporation because North Dakota law did not allow for the transfer of farmland to a corporation.[98] The IRS challenged this arrangement after the death of the decedent and the

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[92] 26 U.S.C.A. § 2032A(b)(2).

[93] 26 U.S.C.A. § 2032A(b)(1), (b)(2); Treas. Reg. § 20.2032A-3(a) (as amended in 1981).

[94] 26 U.S.C.A. § 2032A(b)(2).

Both "farm" and "farming purposes" are also defined in § 2032A(e)(4) and (e)(5). The term "farm" includes stock, dairy, poultry, fruit, furbearing animal, and truck farms, plantations, ranches, nurseries, ranges, greenhouses or other similar structures used primarily for the raising of agricultural or horticultural commodities, and orchards and woodlands. § 2032A(e)(4). The term "farming purposes" means cultivating the soil or raising or harvesting any agricultural or horticultural commodity (including the raising, shearing, feeding, caring for, training, and management of animals) on a farm; handling, drying, packing, grading, or storing on a farm any agricultural or horticultural commodity in its unmanufactured state, but only if the owner, tenant, or operator of the farm regularly produces more than one-half of the commodity so treated; and the planting, cultivating, caring for, or cutting of trees, or the preparation (other than milling) of trees for market. 26 U.S.C.A. § 2032A(e)(5).

[95] *See generally* 26 U.S.C.A. § 2032A.

[96] 26 U.S.C.A. § 2032A(c)(1).

[97] *See* Minter v. United States, 19 F.3d 426 (8th Cir. 1994).

[98] *Id.* at 427.

spouse.[99] The IRS claimed that the family corporation's cash rental interest did not satisfy its requirement to use the land in a qualified use and was thus subject to recapture.[100] On appeal to the Eighth Circuit, the court held that not only did the family own the portion of the land that was being cash rented, but they also owned a share of the family corporation that was renting the property and performing all of the necessary actions to meet the qualified use requirement of § 2032A.[101] Since the family members were partial owners in the family farming corporation they were also subjecting themselves to "the financial risk of farming" as opposed to being "mere landlords." [102] The court held that they were entitled to use special use valuation even though their ownership and qualified use requirements were met through a corporate entity.[103]

6. Material Participation

To target § 2032A directly to active farmers and business people, instead of mere investors, special use valuation requires material participation in the farming or business operation.[104] It is one of the more complex requirements stipulated in the statute and "does not focus on how the property was used. Instead, the standard considers the decedent's or family member's level of participation in the farm or business."[105]

Qualification under § 2032A can be essentially broken down into two separate parts. First, both the decedent and the heirs must qualify in order to use special use valuation and second there are qualifications and exceptions to the material participation requirement. Both are critical in understanding the material participation requirement and because many determinations on eligibility hinge on the parties meeting this part of the statute, particular attention must be paid to it in order to safely and effectively make the election.

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[99] *Id.* at 428.

[100] *Id.*

[101] *Id.* at 428-29.

[102] *Id.*; *see* also Schuneman v. United States, 783 F.2d 694, 699-700 (7th Cir. 1986) (where the cash leases were adjustable for production between decedent and nonfamily member thus qualifying as having a financial risk in the farming operation). *But see* Brockman v. Comm'r, 903 F.2d 518, 525 (7th Cir. 1990) (in which there was a cash lease between decedent and unrelated farmer-neighbor which left that portion of the farm unavailable for special use valuation); Heffley v. Comm'r, 884 F.2d 279, 280-81, 285 (7th Cir. 1989) (where a cash lease between decedent's lifetime trustee, his son, and relatives outside family circle was held not to meet the qualified use requirement); Williamson v. Comm'r, 974 F.2d 1525, 1533-34 (9th Cir. 1992) (where the cash lease between decedent's son and son's nephew was classified as passive rental income because the decedent's son did not undertake financial risk in operating a farming operation).

[103] Minton, 19 F.3d at 429-30.

[104] W. Ralph Rogers, Jr., *Material Participation under the Passive Activity Loss Provisions*, 39 U. FLA. L. REV. 1083, 1100 (1987).

[105] *Id.*

(a) Of the Decedent and Heirs

The decedent and the qualified heirs both must be able to meet the material participation requirement before the estate can qualify to use the special use valuation.[106] Whether a decedent or qualified heirs meet the material participation condition "is a factual determination, and the types of activities and financial risks which will support such a finding will vary with the mode of ownership of both the property itself and of any business in which it is used."[107] The general rule is that the participation must be active in order to be material and the regulations require that the decedent, family member, and/or qualified heirs be employed "on a substantially full-time basis . . . or to any lesser extent necessary personally to manage fully the farm or business" that is being valued by special use valuation.[108] However, the Code regulations do allow for other factors to be assessed in the determination of whether material participation has occurred.[109] In *Heffley v. Comm'r,* the Seventh Circuit held that a son who was away at college did not meet the material participation requirements even though he actively farmed a small portion of the land and occasionally helped with the rest of the land when he was not in school. [110] Later, Congress amended the statute to exempt children in school from the material participation requirement.

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[106] 26 U.S.C.A. § 2032A(b)(1)(C) (West 2012).

[107] Treas. Reg. § 20.2032A-3(a) (as amended in 1981).

[108] Treas. Reg. § 20.2032A-3(e)(1) ("Actual employment of the decedent (or of a member of the decedent's family) on a substantially full-time basis (35 hours a week or more) or to any lesser extent necessary personally to manage fully the farm or business in which the real property to be valued under section 2032A is used constitutes material participation. For example, many farming operations require only seasonal activity. Material participation is present as long as all necessary functions are performed even though little or no actual activity occurs during nonproducing seasons. In the absence of this direct involvement in the farm or other business, the activities of either the decedent or family members must meet the standards prescribed in this paragraph and those prescribed in the regulations issued under section 1402(a)(1).").

[109] Treas. Reg. § 20.2032A-3(e)(2) ("No single factor is determinative of the presence of material participation, but physical work and participation in management decisions are the principal factors to be considered. As a minimum, the decedent and/or a family member must regularly advise or consult with the other managing party on the operation of the business. While they need not make all final management decisions alone, the decedent and/or family members must participate in making a substantial number of these decisions. Additionally, production activities on the land should be inspected regularly by the family participant, and funds should be advanced and financial responsibility assumed for a substantial portion of the expense involved in the operation of the farm or other business in which the real property is used. In the case of a farm, the furnishing by the owner or other family members of a substantial portion of the machinery, implements, and livestock used in the production activities is an important factor to consider in finding material participation. With farms, hotels, or apartment buildings, the operation of which qualifies as a trade or business, the participating decedent or heir's maintaining his or her principal place of residence on the premises is a factor to consider in determining whether the overall participation is material. Retention of a professional farm manager will not by itself prevent satisfaction of the material participation requirement by the decedent and family members. However, the decedent and/or a family member must personally materially participate under the terms of arrangement with the professional farm manager to satisfy this requirement.")

[110] Heffley v. Comm'r, 884 F.2d 279, 286 (7th Cir. 1989).

Additionally, "[p]assively collecting rents, salaries, draws, dividends, or other income from the farm or other business is not sufficient for material participation, nor is merely advancing capital and reviewing a crop plan or other business proposal and financial reports each season or business year."[111] In *Estate of Trueman v. United States,* the court affirmed the exclusion of property that earns passive income where the decedent had used real estate as rental property for homes and businesses in which he took no active role in managing or operating.[112]

For farming purposes, the courts have found many different factors relevant. The U.S. Tax Court in *Estate of Ward* held that the material participation requirement of § 2032A was met when the decedent, a widow of a farmer, maintained an oral sharecropping lease, paid all expenses concerning liming and installing drainage tiles, and resided on the farm until her death.[113] However, in *Estate of Coon v. Comm'r,* the U.S. Tax Court held that a crop-share lease where the decedent paid for half of the seed, all of the taxes, and maintenance on the buildings, coupled with infrequent advice to experienced farmers was not enough to satisfy the material participation requirements of the statute.[114]

Since material participation is a factual determination, the IRS has listed several factors that may be determinative of whether material participation has occurred. Physical work and making management decisions are the most important of the factors, and while the decedent does not necessarily need to perform all of the physical labor or make all of the management decisions they should perform a substantial portion of one or both of the activities.[115] A year after the *Heffley* case, the Seventh Circuit in *Brockman v. Comm'r* stated that another factor in determining whether the material participation requirement is met is whether the decedent or member of the decedent's family is exposed to the financial risk of farming.[116]

Perhaps one of the principal indicators of what constitutes material participation is found in an example in the Code of Federal Regulations on special use valuation and material participation.[117] In this example, the decedent was a doctor that owned a tree farm and contracted out the work to a professional forester.[118] The doctor inspected the property at least twice a year and the doctor approved the forester's management plan on a yearly

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[111] Treas. Reg. § 20.2032A-3(a).
[112] Estate of Trueman v. United States, 6 Cl. Ct. 380, 386 (1984).
[113] Estate of Ward v. Comm'r, 89 T.C. 54, 56, 65 (1987).
[114] Estate of Coon v. Comm'r, 81 T.C. 602, 612 (1983).
[115] Treas. Reg. § 20.2032A-3(e)(2).
[116] Brockman v. Comm'r, 903 F.2d 518, 522 (7th Cir. 1990).
[117] Treas. Reg. § 20.2032A-3(g)(7).
[118] *Id.*

basis.[119] The land had been reforested and was in the beginning stages of growth.[120] The doctor's activity was found to meet the material participation requirement because due to the type of operation the doctor's activity amounted to more than managing an investment even though he invested very little time or effort in managing and none in operating the forestry operation.[121] It appears that the operation itself dictates how much physical labor and management are required to meet the material participation requirement. Operations that are labor and management intensive will require much more effort on the part of the decedent and the qualified heirs than an operation that requires little or no active participation. The decedent and his or her heirs must perform a substantial portion of the activities that the operation in question requires in order for it to be successfully operated.[122]

(b) Qualifications and Exceptions to Material Participation

During an aggregate of five of the eight years ending at the decedent's death, the decedent or a member of the decedent's family must have materially participated in the farming operation subject to several important exceptions.[123] These exceptions may affect both what constitutes material participation and whether the participation of the decedent and qualified heirs has been satisfied. Certain situations do not require the parties to reach the usual standard of involvement. For example, land that is enrolled in a land diversion program sponsored by the United States Department of Agriculture will count as having reached the material participation requirements for those acreages that are enrolled in the programs whether they are enrolled by the decedent or by the heirs.[124]

For decedents or qualified heirs that would otherwise have to meet the material participation requirement, there are exceptions provided in the statute and regulations that provide a way around the harsh consequences of failure to meet that requirement. One important exception occurs if the decedent was retired or disabled at the time of his or her death, which is determined by the receipt of Social Security or disability payments, for a continuous period of time ending at death.[125] Under this exception, the eight year time period counts back from the date on which such payments began.[126] This exception can allow for a significant gap in time between the

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[119] *Id.*
[120] *Id.*
[121] *Id.*
[122] *See* Treas. Reg. § 20.2032A-3(e)(2).
[123] 26 U.S.C.A. § 2032A(b)(1)(C)(ii) (West 2012).
[124] I.R.S. Announcement 83-43, 1983-10 I.R.B. 28.
[125] *See* 26 U.S.C.A. § 2032A(b)(4)(A).
[126] 26 U.S.C.A. § 2032A(b)(4) (explaining that an individual is considered disabled for purposes of tolling the material participation time period "if such individual has a mental or physical

required material participation of the decedent and his or her death. This is extremely important in facilitating the use of the statute because not only can the executor of the estate look back to when the decedent was not disabled or retired, but there may be appointments of conservators that stepped in and satisfy the material participation requirement as well.[127] In *Mangels v. United States*, the IRS attempted to deny special use valuation because the decedent was mentally and physically incapacitated during the entire eight year period before her death and elected to have a bank serve as her conservator.[128] The bank leased the land to unrelated parties, inspected the farm, and worked closely with the tenants in management decisions.[129] The Eighth Circuit held that the actions on behalf of the decedent as the conservator of her estate satisfied the material participation requirements of § 2032A.[130]

Another important exception applies when the decedent was the surviving spouse of a person who met the material participation requirement, in this situation "active management" alone will be treated as material participation.[131] This provision is not only for the surviving spouse of the person that was materially participating, but also "eligible qualified heir[s]" such as those who have not attained the age of twenty-one, the disabled, and students as long as they remain an eligible qualified heir.[132] These exceptions were crafted to avoid seemingly unjust results in the application of the statute, such as in the *Heffley*, where special use valuation was denied because the heir was a student away at college and could not meet the regular material participation requirements without leaving school until the time requirement was satisfied. To further assist qualified heirs, most importantly the surviving spouse, Congress has also allowed the years of material participation of the decedent to be tacked on to that of the heir in order for them to reach the minimum five years of material participation or active management.[133] This requirement must be met in order for an

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impairment which renders him unable to materially participate in the operation of the farm or other business.").

[127] *See generally* Mangels v. United States, 828 F.2d 1324 (8th Cir. 1987).

[128] *Id.* at 1325-26.

[129] *Id.* at 1325.

[130] *Id.* at 1330.

[131] 26 U.S.C.A. § 2032A(b)(5)(A) (If property is qualified real property with respect to a decedent (hereinafter in this paragraph referred to as the "first decedent") and such property was acquired from or passed from the first decedent to the surviving spouse of the first decedent, for purposes of applying this subsection and subsection (c) in the case of the estate of such surviving spouse, active management of the farm or other business by the surviving spouse shall be treated as material participation by such surviving spouse in the operation of such farm or business).

[132] 26 U.S.C.A. § 2032A(b)(7)(C).

For those eligible qualified heirs that are students or disabled than a conservator or a guardian may step in and fulfill the active management requirement; however, this only applies to fiduciaries of the eligible qualified heir and not to agents. *See* 26 U.S.C.A. § 2032A(c)(7)(B).

[133] 26 U.S.C.A. § 2032A(b)(5).

election to successfully be made under this Code provision; more importantly, for the heirs these must be maintained for ten years.[134]

Succession planning becomes critical to any estate plan attempting to use special use valuation to limit the amount of estate taxes payable. If the qualified heirs are unable to use the property in a qualified use for the full ten-year period, they will be subject to the recapture provision of § 2032A.[135] Therefore, if the decedent has some heirs that will not participate in the farming operation then the plan should account for this by giving non-qualifying real and personal property to these heirs while bequeathing the farmland and other qualifying property to the qualified heirs. The estate planner and the executor/trustee must explain the importance of maintaining the qualified use for the full ten years. The qualified heirs should be closely examined in order to determine if they will be able to continue the business or farming operation from both a financial and management perspective before the election is made.

B. Determining whether to Elect Special Use Valuation

Unlike many tax provisions, the election of § 2032A incorporates many highly personal and complicated factors into the decision making process. The first is determining whether or not the estate in question needs special use valuation to lower its estate tax burden. Only a relatively small percentage of estates even pay federal estate taxes.[136] For those estates that may owe taxes, there are numerous strategies available that can reduce or eliminate the need to pay such taxes that are simpler to use and do not require material participation by the heirs for ten years.[137]

If the estate planner has decided that the estate could benefit by electing special use valuation, then they must determine if the estate can meet the rigorous requirements. Essentially, the decedent, the farming operation or closely-held business, and the heirs of the decedent must all qualify under the statute, the regulations, and the case law in order for the option to use special use valuation to be open to the estate. Not only does the estate have to qualify, but the heirs must maintain their eligibility through material participation for ten years after they have received that qualified real property or they will be held liable for the recapture of the foregone taxes.[138]

Finally, if estate can meet the requirements, the overall benefit and whether such benefit is worth it should be determined. As § 2032A

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[134] 26 U.S.C.A. § 2032A(c)(1).

[135] *Id.*

[136] *See Estate Tax Statistics*, INTERNAL REVENUE SERV., http://www.irs.gov/pub/irs-soi/10esesttaxsnap.pdf (last visited Mar. 3, 2012).

[137] *See generally* Susan C. Frunzi, *The Federal Estate Tax*, 317 PLI/EST 95 (2002).

[138] 26 U.S.C.A. § 2032A(c)(1).

currently exists, a qualifying estate may lower the value of real property from its highest and best use to the value of the property at its current use by up to $940,000, as of 2007.[139] The Unified Credit amount for a decedent dying in the year 2011 is $5,000,000, meaning a husband and wife with simple estate planning techniques can easily exclude $10,000,000.[140] The Unified Credit is automatic and there are several other strategies that can further lower the amount of estate taxes payable without resorting to special use valuation.[141] If special use valuation is used, then the $940,000 that the statute currently allows only provides the estate with a relatively small fraction of the total benefits provided by a well-crafted estate plan, somewhere less than twelve percent of the total amount of discounts and credits depending upon the situation. This leaves the estate planner with an important question: is it worth the trouble to elect special use valuation as the statute is now?

V. CURRENT LEGISLATIVE EFFORTS FOR § 2032A

Congress modified § 2032A numerous times since the section was passed in the 1970s. Section 2032A was created to make it easier for family members to pass farms and closely-held businesses onto their children or other qualified heirs.[142] Special use valuation provides an incentive to the next generation to continue the farm or business in order to reap the benefits of the lower valuation of real property associated with the use of this provision.[143] Congress intended that the statute would provide a means by which family-owned businesses and farms could be passed down to the next generation without heirs having to sell off critical assets in order to pay estate taxes.[144] It also serves to entice those heirs that might normally sell off the farm or business to attempt to carry it on themselves. One aspect of the code section that remains relatively unchanged compared to the Unified Credit is the amount of the allowed decrease in value that is indexed for inflation. In 1983, the limit on the reduction in value was set at $750,000 and since that time this amount has been allowed to creep upwards with inflation to $940,000, as of 2007.[145]

Agriculture has changed greatly since the early 1980s. The number of very large farms has increased as well as the cost of land and

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[139] *See* 26 U.S.C.A. § 2032A(a)(2), (a)(3).

[140] 26 U.S.C.A. § 2010(b) (West 2010)

[141] *E.g.*, 26 U.S.C.A. § 2702 (West 1996) (Grantor Retained Annuity Trusts); 26 U.S.C.A. § 2032 (West 2012) (alternate valuation dates); 26 U.S.C.A. § 2057 (West 2004) (qualified family-owned business interest deductions).

[142] *See* H.R. REP. NO. 94-1380, at 3 (1976).

[143] *See generally* 26 U.S.C.A. § 2032A.

[144] H.R. REP. NO. 94-1380, at 3.

[145] 26 U.S.C.A. § 2032A(a)(3).

equipment.[146] The agricultural industry remains cyclic so these increases in costs have varied from year to year, but the overall trend is for prices to climb ever higher.[147] Section 2032A provided a tool for estate planners to reduce a significant proportion of the estate tax facing families that wished to pass on their farming operations to the next generation. The effectiveness of this provision depends upon a host of factors such as crop values, land prices, input prices, etc. Currently, § 2032A does not provide much in the way of benefits to estate planners or farming families. One reason for this is that the provision is of greater use in a strong economy when prices for land are high because land values typically make up the bulk of a farmer's estate. As the economy grows stronger land prices will once again increase, which will in turn bring about more special use valuation elections. The second reason is that the reduction in value currently offered is low. The reduction in value is noticeably low when compared with other options and § 2032A is much harder to qualify for since it is a continuing obligation on the part of the heirs.

To remedy this issue there have been several bills introduced in the House of Representatives and the Senate. The "Save Family-Owned Farms and Small Businesses Act of 2009" was introduced in the House on January 6, 2009, to increase the allowed reduction in value to $1,850,000, which would be indexed to inflation.[148] The Senate has also introduced the "Taxpayer Certainty and Relief Act of 2009," which calls for the allowed reduction in value to equal $3,500,000, the amount then allowed under the Unified Credit [149] Neither bill is being actively considered at this time; however, either bill would increase the usefulness of § 2032A to executors of estates that are tasked with deciding whether or not to make the election. Currently, there is only one bill active, the "Family Farm Preservation and Conservation Estate Tax Act," which would "provide an exclusion from the gross estate for certain farmlands and lands subject to qualified conservation easements."[150] However, there has been little movement on this bill, and there will probably be none in the foreseeable future.

VI. CONCLUSION

Presently, § 2032A is of little value to the vast majority of estate planners because of the high Unified Credit amount. However, despite the

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[146] *See* ECON. RESEARCH SERV., U.S. DEP'T OF AGRIC., STRUCTURE AND FINANCES OF U.S. FARMS: FAMILY FARM REPORT, EIB-24, at 7-9 (2007), *available at* http://www.ers.usda.gov/publications/eib24/eib24b.pdf.

[147] POLICY VOLATILITY IN FOOD AND AGRICULTURE MARKETS: POLICY RESPONSES, at 9 (June 2, 2011), *available at* http://www.oecd.org/dataoecd/40/34/48152638.pdf.

[148] H.R. 96, 111th Cong. (2009).

[149] S. 722, 111th Cong. (2009).

[150] H.R. 390, 112th Cong. (2011).

fact that § 2032A is of little value today, it may become important in the future because use of this provision closely resembles the cyclic nature of agriculture. Farm size continues to increase in commercial farms and land prices will most likely increase in the future. Additionally, the secondary value of the legislative, administrative, and judicial changes to the statute over the decades provides lawmakers with a guide to craft future legislation that more closely targets selected groups or issues, as can be seen in the proposed "Family Farm Preservation and Conservation Estate Tax Act".[151] Predictions on the future status of the federal estate tax and the importance of § 2032A in its role as a valuation tool are extremely difficult to make, however the history of the statute and the lessons that one can take away from it may prove to be extremely beneficial to lawmakers as they craft future agricultural policy.

[151] *See id.*